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In the Supreme Court of the United States

OCTOBER TERM, 1958.

No. 663.

MONROE ZIPP, *et al.*,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

REPLY BRIEF OF PETITIONERS.

FRED H. MANDEL,
731 Leader Building,
Cleveland, Ohio,
Counsel for Petitioners.

ROCKER, ZALLER & KLEINMAN,
BENNET KLEINMAN,
FRED SIEGEL,
731 Leader Building,
Cleveland, Ohio,
Of Counsel.

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I.

Respondent, in its Brief in Opposition to Petitioners' Petition for a Writ of Certiorari, states at page 6 that:

> "Whether or not a corporate distribution constitutes payment for property purchased on behalf of a stockholder and whether or not a distribution in connection with a cancellation or redemption of stock is essentially equivalent to a taxable dividend constitute questions of fact."

In support of this statement the Respondent cites two cases decided by this Honorable Court, both of which do not support this conclusion. In *John Kelley Co. v. Commissioner* (1946) 326 U. S. 521, the issue was whether distributions by a corporation as interest on the corporation's debentures were in effect interest or dividends. This Honorable Court applied the *Dobson* rule announced in *Dobson v. Commissioner* (1943) 320 U. S. 489 and held

that the conclusion of the Tax Court should be accepted by the Court of Appeals and by this Honorable Court. *However*, in 1948, section 1141(a) of the 1939 Code (substantially section 7482 of the 1954 Code) was added by Congress expressly to repeal the rule laid down in the *Dobson* case. Pub. Law. 773, Sec. 36, 80th Cong. 2nd Sess.; Sen. Rep. No. 1559, 80th Cong. 2nd Sess. (1948). It is obvious the *Kelley* case cited by the Respondent can have no application to the case at bar.

In *Bogardus v. Commissioner* (1937) 302 U. S. 34, cited by Respondent, the issue was whether or not payments made to employees were compensation or gifts. In contradiction to Respondent's citation of this case as authority for its quoted statement, this Honorable Court said that the questions presented were:

> "'* * * a conclusion of law, or at least a determination of a mixed question of law and fact. It is to be distinguished from findings of primary, evidentiary or circumstantial facts. It is subject to judicial review and, on such review, the court may substitute its judgment for that of the Board.' *Helvering v. Tex-Penn Oil Co.*, 300 U. S. 481, 491; *Helvering v. Rankin*, 295 U. S. 123, 131. That the conclusion of the Board be regarded as a determination of a mixed question of law and fact, it has as we shall presently show, no support in the primary and evidentiary facts. The ultimate determination, therefore, should be overturned under the doctrine of *Helvering v. Rankin*, supra, as a matter of law." (p. 39.)

Sec. 1141(a) of the 1939 Code provides for review of the Tax Court decisions "in the same manner and to the same extent as decisions of the District Courts in civil actions tried without a jury." Under Rule 52(a) of the Federal Rules of Civil Procedure "findings of fact shall not be set aside unless clearly erroneous. * * *" However,

the rule that the appellate court is bound by the facts as determined by the Tax Court unless they are "clearly erroneous" is directed *only* to *evidentiary* facts. If the finding involves an *ultimate* fact rather than the evidence on which it is based, the appellate court may substitute its judgment for that of the Tax Court. See *Commissioner v. Heininger* (1943) 320 U. S. 467, 475; *Helvering v. Tex-Penn Oil Co.* (1937) 300 U. S. 481, 491; *Bogardus v. Commissioner, supra; Botany Worsted Mills v. U. S.* (1929) 278 U. S. 282, 290; *Baumgartner v. U. S.* (1944) 322 U. S. 665; *Smith v. Dunn* (CA 5th 1955) 224 F. 2d 353; *Goldberg v. Commissioner* (CA 5th 1955) 223 F. 2d 709. Insofar as a so-called "ultimate finding" is simply the result reached by processes of legal reasoning from, or the interpretation of the legal significance of, the evidentiary facts, it is "subject to review free of the restraining impact of the so-called 'clearly erroneous' rule." *Lehmann v. Acheson* (CA 3rd 1953) 206 F. 2d 592, 594; *Hypotheek Land Co. v. Commissioner* (CA 9th 1952) 200 F. 2d 390. Findings of fact that are induced by an erroneous view of the law are not binding. Nor are findings that combine both fact and law, when there is error as to the law. *Galena Oaks Corp. v. Scofield* (CA 5th 1954) 218 F. 2d 217.

The issue in the case at bar of whether Paramount Steel and Supply Co.'s distribution to Louis Zipp was essentially equivalent to taxable dividends received by Petitioners is a conclusion of law, or at least a combined finding of fact and conclusion of law. *Bogardus v. Commissioner, supra; Wilson v. U. S.* (CA 2nd 1958) 257 F. 2d 534; *Earle v. Woodlaw* (CA 9th 1957) 245 F. 2d 119, cert. den. 354 U. S. 942; *Northup v. U. S.* (CA 2nd 1957) 240 F. 2d 304; *Pacific Vegetable Oil Corp. v. Commissioner* (CA 9th 1957) 251 F. 2d 682. This Honorable Court has always had the power "to modify or to reverse" such decisions.

II.

Petitioners admit that the statements of law made by Respondent in its brief in paragraph 1 beginning on p. 7 may be supported by the cases cited. However, the controlling fact present in all the cases cited by Respondent was that the corporation's distribution, whether for purchase of stock or otherwise, satisfied or discharged some obligation or indebtedness of the remaining stockholders. This satisfaction or discharge of the remaining stockholders' indebtedness or obligation was the benefit received which constituted a constructive dividend to them.

In the case at bar, however, the Courts below did not find any agreement between Louis Zipp and Petitioners relating to Louis' transfer of stock, nor did the Courts below find that the Petitioners in any way obligated themselves personally to pay for any part of the stock sold by Louis Zipp. The only existing obligation to pay for the shares purchased was the obligation of the corporation, Paramount Steel and Supply Co., under its agreement with Louis Zipp executed May 29, 1950.

A serious error in Respondent's statement of facts must be pointed out. Respondent states (Resp. 3):

> "Sometime thereafter, Louis and his sons, all of whom were officers of Paramount, became involved in controversies concerning the operation of the business of Paramount as a result of which *it was orally agreed that the sons would purchase the business.*" (Emphasis supplied.)

No such agreement was found to exist by the Tax Court. In fact the Court in its opinion (R. 127a) states as follows:

> "The record as a whole establishes that *Monroe and Bernard decided* on May 28th to purchase all of Louis' interest in the corporation, but *they were without suf-*

ficient funds to make the purchase themselves. * * *"
(Emphasis supplied.)

After finding that the corporation then arranged for a loan with which it proceeded to purchase Louis' stock (R. 127a), the Court further stated:

> "*In effect* they (petitioners) caused Paramount's cash to be distributed for their benefit, i.e., to purchase all of Louis' stock. * * * The arrangement had the same *effect* as though the sole stockholders had withdrawn funds from Paramount for their own use and benefit." (Emphasis supplied.)

This is certainly not a finding of an oral agreement between Monroe and Bernard on the one hand and Louis Zipp on the other, involving the purchase of Louis' stock.

Therefore, this contention of Respondent must also fall since this controlling or essential fact is lacking in the case at bar.

III.

Respondent argues that the decisions in the case at bar are not in conflict with *Holsey v. Commissioner* (CA 3rd 1958) 258 F. 2d 865, since in *Holsey* the corporation, not the remaining stockholders, purchased the stock in question (Resp. 8-9).

Here again Respondent relies upon a fact which the Tax Court *did not find*, viz., that Petitioners and not the corporation bought Louis Zipp's stock. The essential facts of the *Holsey* case and the case at bar are the same.

Respondent further says that the instant case is not in conflict with *Tucker v. Commissioner* (CA 8th 1955) 226 F. 2d 177, since in *Tucker* the distribution by the corporation served a proper corporate purpose, while in the case at bar no such corporate purpose was served. In the first instance, whether or not a proper corporate purpose

is served by the corporation's purchase of stock is irrelevant. It is the *effect* of the transaction rather than the *purpose* which actuated it which controls. *Holsey v. Commissioner, supra; Northup v. U. S.* (CA 2nd 1957) 240 F. 2d 304.

However, if a proper corporate purpose is deemed a consideration in the instant case, it is clear that Paramount Steel and Supply Co.'s purchase of Louis Zipp's interest in the corporation did serve a proper corporate purpose, namely, to insure harmony in the management of the corporation. The Tax Court here found constant bickering and dissension between Louis Zipp and Petitioners regarding the management of the corporation culminating in threats by Louis which, if carried out, would have been harmful to Paramount's business (R. 113a-114a). See *Emeloid Co. Inc. v. Commissioner* (CA 3rd 1951) 189 F. 2d 230, 233.

CONCLUSION.

Since this Honorable Court does have the power to review and reverse or modify the decisions of the courts below, and because the decisions here are in conflict with decisions of other circuits of the United States Court of Appeals, and for the further reasons set forth in the Petition for Writ of Certiorari, it is respectfully submitted that said petition be granted.

Respectfully submitted,

FRED H. MANDEL,
Counsel for Petitioners.

ROCKER, ZALLER & KLEINMAN,
BENNET KLEINMAN,
FRED SIEGEL,
Of Counsel.